

FEB 25 1991

Chief, Section 1, Quality Assurance Branch, Newark E:QAB:ES

Senior Technician Reviewer, Branch 1, Office of Assistant
Chief Counsel (Income Tax & Accounting CC:IT&A

Request for Technical Assistance - Section 6041, Information
Return Requirements for Farmland Preservation Development
Easements

This is in reply to your request for assistance regarding whether county governments in the State of New Jersey are required to file information returns when making payments to farmers under the State Farmland Preservation Development Easement Program (Program).

Under the Program, farmers are paid for the development rights to their property in order to preserve open space for agricultural purposes. The farmers/grantors retain the use of the land for agricultural purposes and therefore enjoy beneficial use of the property. Currently, the easements are perpetual; however, in the future the State may also obtain limited term easements.

Under the Program, the State gives a portion of the agreed upon consideration to the county government, which adds its portion of the consideration and makes the total payment to the farmer/grantor.

There are two sections of the Internal Revenue Code that could potentially apply to the payments made under the Program - sections 6041 and 6045.

Section 6041 of the Code requires that all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments to which certain Code sections not here relevant apply), of \$600 or more in any taxable year shall render a true and accurate return setting forth the amount of such gains, profits, and income, and the names and address of the recipient of such payment.

Section 6041 of the Code requires that payments of fixed or determinable gains, profits, and income be reported on information returns. ~~The Service's position with respect to the~~

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meaning of the term "income" is that such term is synonymous with "gross income". Only the gain realized on the sale or exchange of property is includible in gross income. Generally, gain is the excess of the amount realized over the unrecovered cost or other basis of the property sold or exchanged. See section 1.61-6(a) of the Income Tax Regulations.

In Rev. Rul. 54-575, 1954-2 C.B. 145, the Service held that the granting of an easement that deprives the taxpayer of practically all of the beneficial interest in a portion of the land covered by the easement (except for the retaining of mere legal title thereto) is considered to be a sale of such portion of the land.

In Rev. Rul. 59-121, 1959-1 C.B. 212, the taxpayer granted an indefinite easement, but retained more than mere legal title to the property affected by the easement inasmuch as the taxpayer retained all oil, gas, and mineral rights, and the use of buildings situated on the land for the entire period of the easement. The contract constituted the grant of an easement in land and not the transfer of the ownership of such land. Accordingly, the revenue ruling held that the consideration received for granting the easement constitutes the proceeds from a sale of an interest in real property. The amount received by the taxpayer was required to be applied as a reduction of the cost or other basis of the land subject to the easement. Any excess of the amount received over the cost or other basis is treated as taxable gain.

In the case of easements acquired under the Program, the farmer/grantor retains a beneficial interest in the land as agricultural property. Therefore, the consideration paid should be used to reduce the cost or other basis of the land. Any excess of the amount received by the farmer/grantor over the cost or other basis would be gain. See Rev. Rul. 59-121.

For purposes of section 6041 of the Code, the amount of the farmer/grantor's gain must be known by the payor in order for the income to be fixed or determinable. Because the payor will not know the farmer/grantor's basis in the land, the gain cannot be calculated; and, consequently, the income will not be fixed or determinable. Therefore, payments made pursuant to the Program are not reportable under section 6041 of the Code.

Section 6045(e)(1) of the Code provides, in the case of a real estate transaction, that the real estate reporting person shall file a return (under section 6045(a)) and a statement (under section 6045(b)) with respect to the transaction.

Section 6045(e)(2) of the Code defines "real estate reporting person" as (1) the person responsible for closing the

transaction, (2) the mortgage lender, (3) the seller's broker, (4) the buyer's broker, or (5) such other person described in regulations prescribed by the Secretary.

Subsequent to your request for technical assistance, temporary and final regulations were issued under section 6045 of the Code pertaining to real estate transactions. These new rules are effective for real estate transactions with dates of closing on or after January 1, 1991.

Section 1.6045-4(a) of the regulations provides that real estate reporting persons (as defined in section 1.6045-4(e)) must make information returns with respect to real estate transactions (as defined in section 1.6045-4(b)).

Section 1.6045-4(b)(1) of the regulations states that a transaction is a "real estate transaction" if the transaction consists in whole or in part of the sale or exchange of "reportable real estate" for money, indebtedness, property other than money, or services. The term "sale or exchange" includes any transaction properly treated as a sale or exchange for Federal income tax purposes, whether or not the transaction is currently taxable.

Section 1.6045-4(b)(2) of the regulations defines reportable real estate as including any present or future ownership interest in land (whether improved or unimproved). The term "ownership interest" includes fee simple interests, life estates, reversions, remainders, and perpetual easements.

Section 1.6045-4(e) of the regulations states that while there may be other persons involved in a real estate transaction, only the reporting person is required to report. Generally, in the absence of a designation agreement, the person responsible for closing the transaction (as determined by the rules set forth in section 1.6045-4(e)(3)) is required to report. If there is no person responsible for closing the transaction then the person required to report is determined according to the rules set forth under section 1.6045-4(e)(4).

Section 1.6045-4(e)(4) of the regulations provides that if no person is responsible for closing the transaction, the reporting person is the person first-listed of the persons that participated in the transaction as (1) the mortgage lender, (2) the transferor's broker, (3) the transferee's broker; or (4) the transferee.

Section 1.6045-4(e)(6)(iv) of the regulations defines "transferee" as the person who acquires the greatest interest in the real estate. If there is no such person, the transferee is the person listed first on the document(s) transferring legal or

equitable ownership of the real estate.

Real estate transactions involving perpetual easements are subject to information reporting under section 6045(e) of the Code if the closing takes place on or after January 1, 1991. Perpetual easements will be required to be reported regardless of whether the granting of the easement constitutes a sale or exchange of the land as is discussed in Rev. Rul. 54-575, or is merely a sale of an interest in real property as in Rev. Rul. 59-121.

The obligation to report the payments made under the Program will fall on the transferee (either the State of New Jersey or its counties) as is provided for in section 1.6045-4(e)(4)(iv) of the regulations, unless another person can be considered responsible for closing the transaction under section 1.6045-4(e)(3) or is first-listed in section 1.6045-4(e)(4). Whether the State of New Jersey or a county is considered the transferee is determined in accordance with section 1.6045-4(e)(6)(iv).

This reply is advisory only and does not represent an expression of the views of the Internal Revenue Service as to the applicable law, regulations, and precedents to the facts of a specific case. The reply is not to be furnished or cited to taxpayers or representatives, and is not to serve as the basis for closing a case.

If you have any questions about this memorandum please call John McGreevy at FTS 566-6302.